



ANNUAL REPORT

2003

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JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
MICHIGAN BROADBAND DEVELOPMENT AUTHORITY
LANSING

JAMES W. BUTLER, III
VICE PRESIDENT

March 1, 2004

I. President's Message

In accordance with PA 49 of 2002, section 484.3224 of the Michigan Compiled Laws, I submit the 2003 annual report for the Michigan Broadband Development Authority (MBDA). Nearing the completion of our second year, we are beginning to see the results of what happens when a supportive governor, legislature and board of directors, team up with a dedicated staff and consultants that are second to none, to nurture the development of an industry that is transforming the way Michigan residents and businesses conduct and engage in business and leisure activities. Our statutory goal of increasing the deployment and utilization of broadband throughout this state is being realized. We are moving towards ensuring high-speed Internet access by all Michigan residents.

Since our last annual report, we have provided financing to expand broadband service in 27 cities. These include the cities of Battle Creek, Birmingham, Breckenridge, Brighton, Eaton Rapids, Fenton, Howell, Jackson, Kalamazoo, Lansing, Mount Pleasant, Ann Arbor, Detroit, Dexter, Farmington, Livonia, Shepherd, Southfield, Wixom, Alma, Beaverton, Clare, Coleman, Gladwin, Hemlock, Ithaca and Rosebush. The MBDA is presently evaluating in excess of \$20 million in loan applications. When funded, these

projects will expand and/or improve service in several dozen additional cities across the state.

The MBDA has undertaken many progressive steps over the past year. Executive Order 2003-18 consolidated all state economic development and workforce development programs in the Department of Labor and Economic Growth. Additionally, the MBDA moved its Ann Arbor location to Lansing and is housed in the Michigan State Housing Development Authority building (MSHDA). Due to the excellent staffs of MSHDA and the MBDA, our transition to Lansing was organized and executed flawlessly. We are fortunate to be housed at MSHDA and benefit from our ability to draw upon their financial expertise and counsel.

I would like to commend the MBDA staff. While it is exciting to be part of an organization that is promoting the cutting edge of today's technology, being on the cutting edge is challenging. I commend all of the individuals involved in the day to day operations of the MBDA that ensure we provide the necessary oversight and due diligence in connecting all areas of the state.

Finally, I would like to express my gratitude to Suzanne M. Cole and Cyril Moscow for their service on the MBDA Board of Directors. They both served in exemplary fashion and were key contributors in helping the Authority chart its course, set its vision, and establish the right tone for its operations during its first two years. While they will be sorely missed, they ensured the MBDA's stability by sharing their enviable business and

legal skills with us. It has been a pleasure for me to work with them, as well as the staff in making Michigan a national leader in promoting broadband deployment.

Sincerely,

James Butler III, Vice President

Michigan Broadband Development Authority

II. MBDA Board of Directors

Jay Rising, State Treasurer* and Chair (acting)

David Hollister, Director, DLEG*

James W. Butler, III, MBDA Vice President

Rick Laber, Executive Director (acting), MSHDA*

Suzanne Hart Dees (D), Superiorland Library Cooperative

Joel I. Ferguson (D), Ferguson Development LLC

Cyril Moscow (D), Honigman Miller Schwartz & Cohn**

Dr. Timothy Laing (R), University of Michigan Health System

Matthew E. McLogan (R), Grand Valley State University

Suzanne M. Cole (R) Cole and Associates**

President (vacant)

Bond Counsel: Miller, Canfield, Paddock & Stone, P.L.C.

Investment Banker: Goldman Sachs Group, Inc.

Consultants: Mercator Partners, Whyte Financial, Inc. and Joseph P. Nathan

* May appoint a designated representative to serve on the board.

**Term expired on December 31, 2003. Public Act No. 49 of 2002, section 6(d), provides for members appointed by the governor to serve until a successor is appointed.

III. Mission and Goals

The MBDA was created to help the state attract more private sector investment in high-speed Internet infrastructure, and to increase demand for and utilization of broadband services. It does so by offering 1) low-cost loans to telecommunications companies willing to make such investments, and 2) by offering organizations or “broadband users” low-cost financing for the acquisition of broadband service.

The Authority is authorized to issue investment grade, taxable and tax-exempt bonds, the proceeds of which can be used to provide financing assistance. This assistance can be used for supply-oriented investment opportunities. A supply-oriented project is one that expands and/or improves high-speed telecommunications networks. Eligible projects might include expansion of fiber backbone networks, last-mile connectivity solutions (wireless, cable, DSL or other technologies), or network connectivity hardware/software enhancements.

While the Internet economy was crashing over the past few years, the number of subscribers in the country with high-speed Internet connections continued to increase, with a total of 23.5 million as of June 30, 2003. These subscribers predominately have access either through cable modems, digital subscriber lines and fixed wireless connections. According to recent surveys, Michigan’s Internet use mirrors national averages. The MBDA’s goal is to help Michigan exceed these averages and to propel our state forward as a national leader in high-speed Internet utilization.

IV. TechNet

The Technology Network (TechNet) is a national network of more than 150 chief executive officers and senior executives in the high technology and biotechnology industries. In July of 2003, TechNet announced that Michigan led the nation in policies that encourage next generation broadband networks.

This index assessed state policies that impact the deployment and demand of broadband service. When fully adopted, it is estimated that broadband will result in the injection of an estimated \$300 billion annually to the U.S. economy. In an independent study, Gartner, Inc., estimated that Michigan could realize an economic impact of \$440 billion and 500,000 jobs over the next decade by full deployment of broadband.

In 2002, TechNet published its goal of having broadband connections of 100 Mbps to 100 million homes and small businesses by 2010. While this is a very aggressive goal, states will have to be committed to policies conducive for the deployment of broadband services to come close to meeting this projection. Michigan is moving down that road faster than any state in the nation. Policies highlighted by the TechNet study show Michigan's policies will have a significant impact upon broadband deployment.



Michigan ranked #1 in broadband policy in 2003

TechNet Ratings and Scores

| | |
|---------------|-------|
| 1. Michigan | 144.4 |
| 2. Florida | 80.6 |
| 3. Missouri | 75.7 |
| 4. Texas | 73.0 |
| 5. Ohio | 71.1 |
| 6. Washington | 70.0 |
| 7. Kansas | 67.3 |
| 8. Virginia | 65.6 |
| 9. Colorado | 58.5 |
| 10. Iowa | 55.9 |

TechNet is a group of 150 influential technology and business executives

In awarding the top spot, TechNet highlighted Michigan's:

- Access to capital
- Public rights-of-way access
- Tax and permitting fairness
- Community assistance
- Statewide public user aggregation

Michigan's score nearly doubles that of second-place Florida

V. Year in Review/Milestones

- The vision of the Michigan Broadband Development Authority (MBDA) is to:
 - Make Michigan a broadband leader in all respects;
 - Become an engine of economic development;
 - Close the “digital divide” across Michigan;
 - Improve competition in telecom markets;
 - Expand broadband service to rural communities; and,
 - Develop a portfolio of smart and secure loans.

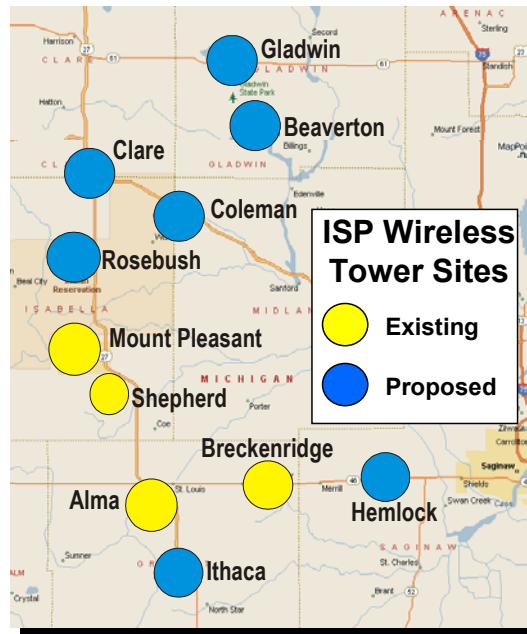
During 2003, the MBDA successfully made the following loans to expand broadband service in Michigan:

ISP Wireless project in mid-Michigan

Project description:

Expansion of fixed wireless broadband service in seven low-to-moderate income communities

\$341,836 commitment for purchase of tower antenna and customer premise equipment



Previously operating in Alma, Mt. Pleasant, Breckenridge and Shepherd, MBDA financing allowed ISP Wireless to purchase additional tower antenna, and customer premise equipment (modems and small antennas) for the new territories, as well as provide more robust service in its existing markets. MBDA financing also allowed ISP Wireless to expand its coverage to the cities of Beaverton, Clare, Coleman, Gladwin, Hemlock, Ithaca and Rosebush.

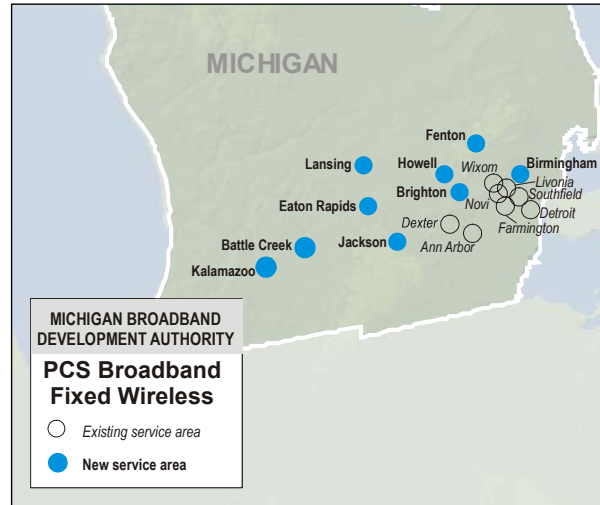
PCS Broadband of Jackson, Michigan/\$510,204

PCS Broadband in southeastern Michigan

Project description:

Expansion of fixed wireless broadband service in areas where small-to-medium sized enterprises (SMEs) are underserved

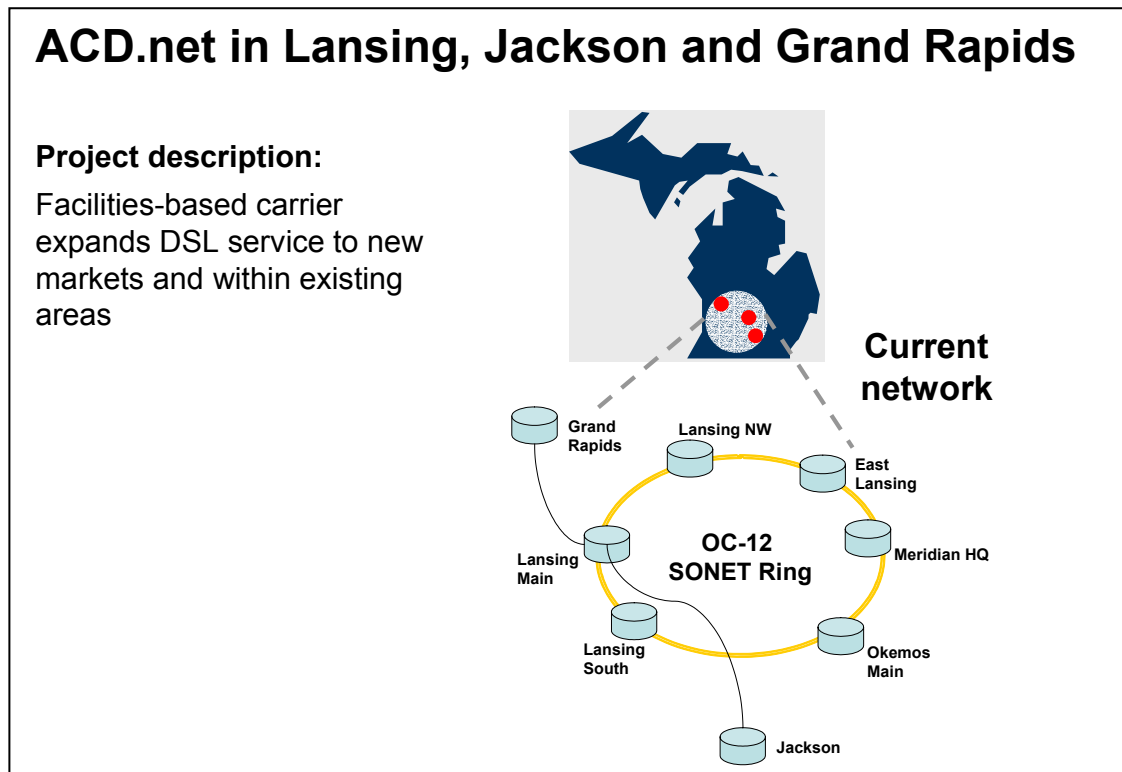
\$510,204 commitment for purchase of tower antenna, routers and customer premise equipment



PCS Broadband previously operated in the cities of Ann Arbor, Detroit, Dexter, Farmington, Livonia, Southfield and Wixom, and specializes in service for small to medium sized businesses in areas where incumbent cable and/or DSL coverage is weak or non-existent. MBDA financing allows PCS to offer its service to the cities of Battle Creek, Birmingham, Brighton, Eaton Rapids, Fenton, Howell, Jackson, Kalamazoo and Lansing, as well as offer more robust service in the cities where it currently exists.

The MBDA has committed to provide financing to expand broadband service in Michigan:

ACD.net of East Lansing, Michigan/up to \$1,200,000



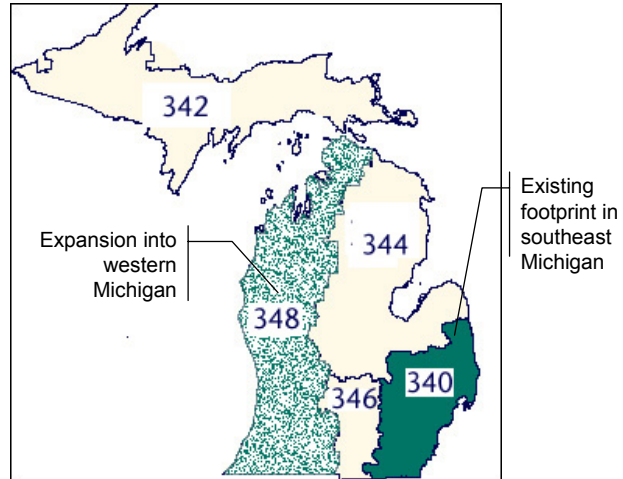
ACD.net previously operated in the cities of East Lansing, Lansing, Grand Rapids, Okemos and Jackson, as a facilities-based phone carrier serving residential and business customers. MBDA financing of \$1.2 million will allow ACD.net to expand its DSL coverage area to new cities (Portland, East Grand Rapids, Mason, Michigan Center, Holt and Haslett) and offer more robust service in its existing coverage areas.

LDMI of Southfield, Michigan/up to \$2,050,000

LDMI Telecommunications in western Michigan

Project Description

- Facilities-based carrier expanding its high-speed data and voice network into western Michigan



Previously operating largely in southeast Michigan and Ohio, LDMI

Telecommunications is a competitive local exchange carrier and plans on expanding its footprint into western Michigan with MBDA financing. The \$2,050,000 MBDA loan commitment allows LDMI to plan its operations to now serve all of west Michigan including the Grand Rapids, Holland, Kalamazoo and Traverse City areas.

Michigan Broadband Development Authority 12-Month Accomplishments:

1. Secured #1 rating in the country for Michigan's Broadband Programs—TechNet
Rating continues to create positive press and perception for economic development in Michigan. The MBDA spent numerous hours courting the TechNet organization as they were compiling data for its study.
2. Closed on first two loans—ISP Wireless of Alma and PCS Broadband of Jackson—expanding broadband service in excess of two-dozen cities across the state.
3. Refined loan application process and created templates for due diligence and loan monitoring functions.
4. Moved offices to Lansing while maintaining loan application activity and business development operations.
5. Retained key staff and recruited three additional team members (Finance Director, Project Manager and Accountant).
6. Developed budget to reduce operational costs by more than 10 percent.

7. Established a targeted “retention/expansion” outreach campaign to help Michigan-based broadband providers grow. The MBDA called upon nearly 100 businesses across the state, resulting in nearly a dozen loan applications.
8. Restructured start-up \$50 million capital agreement with MSHDA—lowering accrued interest expenses and speeding self-sufficiency.
9. Completed 2003 fiscal year audit with no adverse material findings.
10. Received acknowledgement and role in Governor Granholm’s State of the State Address.

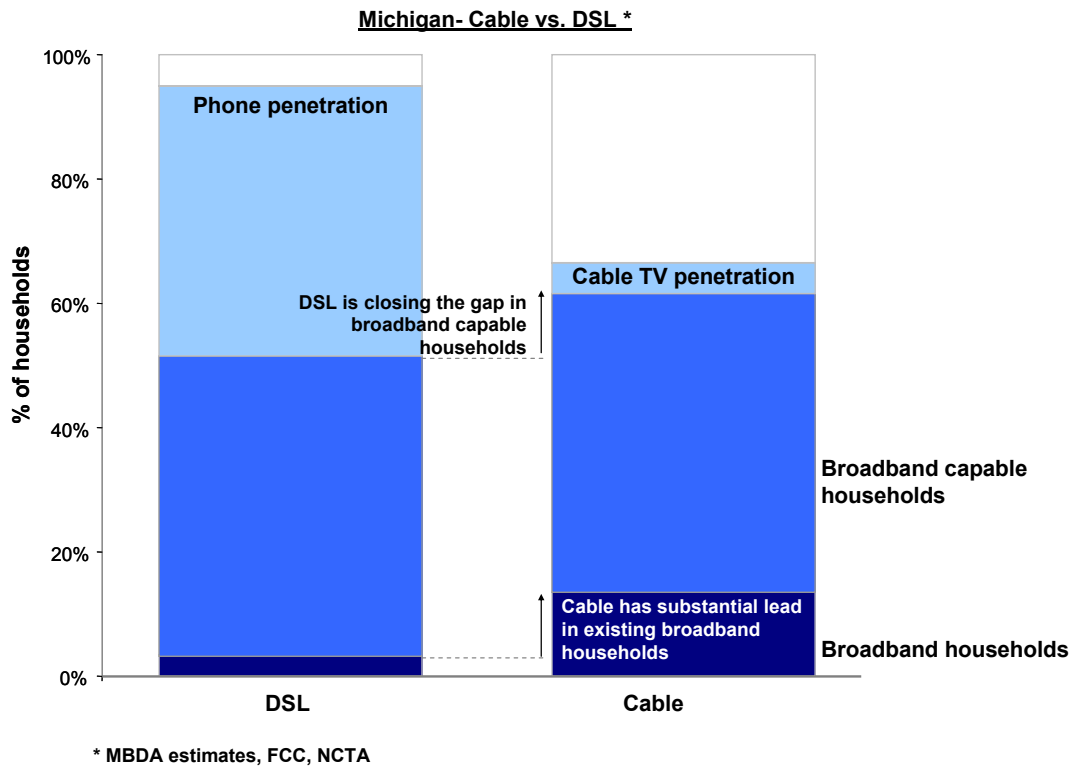
With more than \$13 million in loan requests year-to-date, the MBDA is on track to achieve its 2004 loan portfolio goal (of \$11 million) several months ahead of schedule.

VI. State of Broadband in Michigan

Though broadband penetration in Michigan slightly lags the national average, the state has recently seen an upswing in broadband-related activity (both adoption and deployment). Key indicators of this are:

- *Activity in fixed wireless-* Michigan is a hotbed of fixed wireless broadband activity. The large, sparsely populated, rural areas of the state with low DSL/cable modem access make fixed wireless an attractive option (given the lower rollout costs and flexibility). There are over 30 relatively large wireless Internet service providers in Michigan today. The MBDA has developed projects to bring wireless broadband access to regions of the state where there is virtually no broadband currently available.
- *Substantial growth in DSL-* DSL subscribers in Michigan have grown over 65 percent in the last year alone. DSL players in Michigan have aggressive expansion plans in Michigan in 2004, however, cable modem dominance over DSL is still much more pronounced in Michigan than nationwide.
- *Increasing competition for broadband subscribers-* As in the rest of the nation, Michigan has seen intensifying competition among broadband providers, particularly in urban/sub-urban areas. Providers are using a number of tactics such as aggressive bundling, strategic partnering, lower prices and network enhancements to get broadband subscribers.

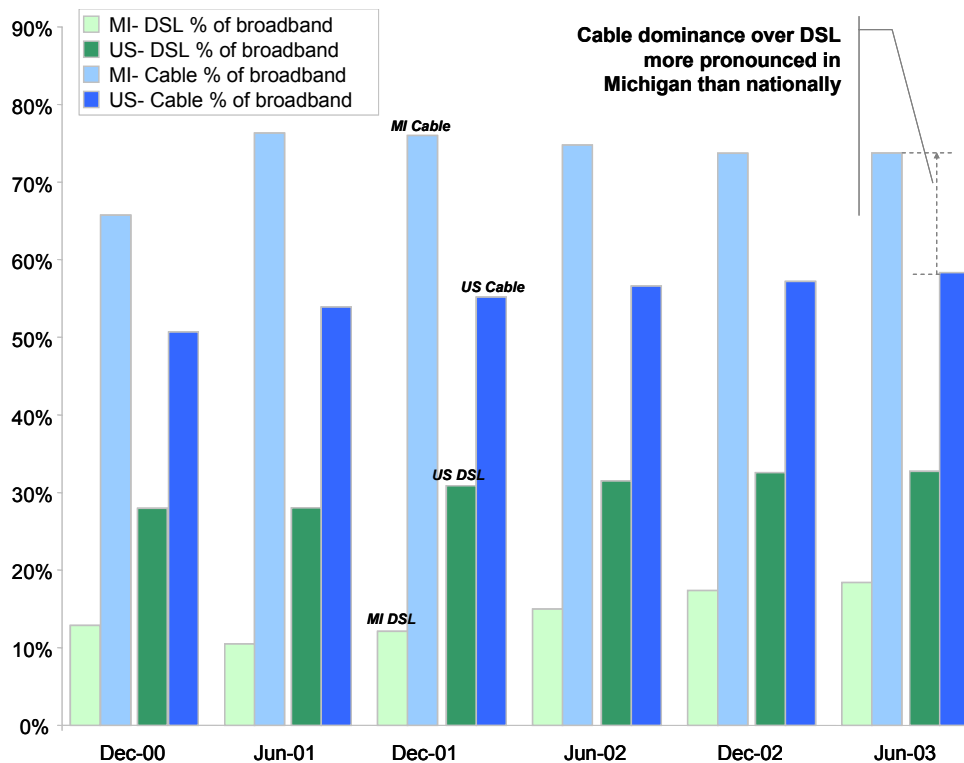
DSL and cable continue to be the predominant forms of broadband access in the state.



Adoption

Usage of broadband in Michigan has gone up substantially in the last few years.

Broadband penetration as a percentage of households has gone up six-fold from 3 percent in 2000 to over 18 percent in 2003. The current penetration as well as rate of growth are still less than the national average (at over 19 percent). Michigan is ranked 25th among US states for broadband penetration.



Adoption- Access Technologies

Nationally, about 58 percent of broadband users utilize cable while 33 percent use DSL (the remaining 9 percent consists of other broadband technologies such as satellite or fixed wireless). This dominance of cable over DSL in terms of subscribers is even more pronounced in Michigan with about 74 percent of broadband subscribers using cable modems and only 18 percent using DSL. Michigan is ranked 7th among states for cable broadband lines, as compared to 14th for DSL. DSL adoption in Michigan however, has increased more rapidly than the national average in the last couple years, and continues to grow at an accelerated pace.

There are also a growing number of subscribers using alternate broadband technologies (over 50,000) – especially fixed wireless broadband in rural areas with low levels of DSL or cable modem availability.

Deployment- Backhaul Infrastructure

Access to competitively priced backhaul is vital for broadband service providers to economically justify serving most rural parts of Michigan. Michigan has a large amount of fiber deployed in the ground. There are over 15 providers of backbone networks in the state. In addition, the large broadband players- such as SBC, Comcast and Charter, run their own intra-Michigan fiber networks to service their customers. These links typically have lower capacity than backhaul fiber. According to the FCC (Dec 2002), Michigan was 7th among states in terms of total fiber kilometers deployed by incumbent local exchange carriers (over 1.959 million fiber kilometers). However, only 19 percent of this is “lit” (i.e. actually used), when compared to almost 40 percent nationally.

Also, a large proportion of the backbone fiber is deployed in the southern, more densely populated parts of Michigan, leaving large gaps in the state: the Upper Peninsula, the Thumb and central Michigan.

Deployment- Last-mile Infrastructure

Sixty-nine percent of SBC’s (the largest DSL provider in Michigan) lines are DSL-capable nationwide and it plans to boost this number to 80 percent by the end of the first

quarter in 2004. In Michigan, however, only 62 percent of SBC's lines are DSL capable, and expansion plans call for this to go up to 70 percent by the end of 2004. While certain areas (such as Detroit metro with 75 percent DSL capable lines today) are close to getting ubiquitous DSL coverage, considerable scope still remains for increased coverage in other areas. Given the relative size of SBC, Verizon and other players in Michigan, it is estimated that over 50 percent of access lines in Michigan are DSL capable today.

About 45 percent of Michigan's cable communities are served by Charter Communications, and 25 percent by Comcast. They both offer cable modem broadband service in over 90 percent of their footprint, so most areas with cable coverage today have access to broadband.

Most of the new DSL coverage growth is in completely new areas, while cable coverage growth appears to be fill-in or in communities adjacent to existing coverage. Despite these coverage builds, there are still large areas with neither service. Also, a large proportion of areas with DSL or cable service have access to only one of the two, limiting the options available to subscribers.

A large number of fixed wireless service providers exist today, especially in areas underserved by DSL and cable. The MBDA has funded several projects to bring wireless broadband access to regions of the state where there is virtually no broadband now available. Wireless broadband has proven to be a low-cost, efficient way to provide service to underserved as well as thinly populated areas where it is expensive to provide DSL or cable modem coverage.

VII. Future Outlook

Roughly 20 percent of Michigan's households now utilize a broadband Internet connection. This is consistent with national averages. In some communities, according to several recent LinkMichigan planning reports, closer to 30 percent of residents have obtained such connections. In communities where there are multiple broadband providers, residential users are paying less than \$30 per month for such service. Those without a choice typically pay \$50 per month for broadband service. There are still a number of areas throughout the state where there is no broadband access available at an affordable price. Satellite service and other alternative delivery methods require high upfront costs that often discourage residential and business use. The MBDA's loans are helping to shrink the number of these locations, by helping to finance customer premise equipment (CPE) and related infrastructure for providers.

Michigan's broadband infrastructure will continue to expand over the next year. Small entrepreneurs will be the driving force behind broadband deployment in rural and underserved markets. Pioneers known as “wireless internet service providers” (WISPs) will lead in these types of expansions. WISPs can quickly establish a network presence, at modest costs, and provide speeds that exceed common high-speed “T-1” connections that many businesses use today. Companies like SpeedNet, ISP Inc., PCS, M-33, Air Advantage, QIX, Arialink and others will continue to grow and become the broadband service providers for many customers across the state. These types of providers are likely to be the leading users of MBDA loans in the coming year.

For more information about the MBDA, please visit www.broadbandauthority.org